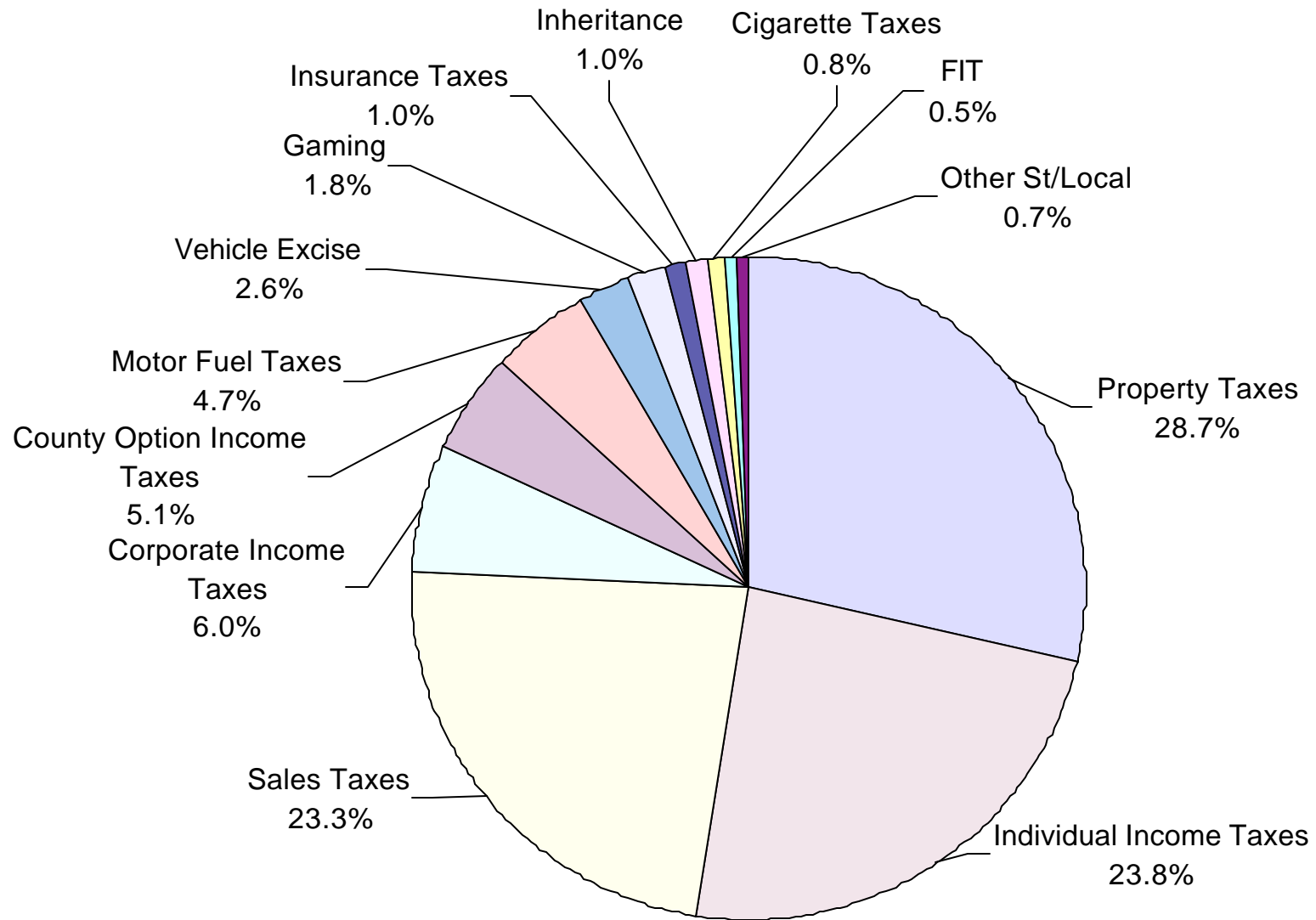




Indiana's 21st Century Tax Plan
October 18, 2001

Indiana State and Local Taxes, 2000



Court-Ordered Tax Shifts

- Tax Shifts with no Shelter Allowance or Change in Personal Property Rule, Change from Current to MV Assessment

Statewide Average:

| <u>Agric</u> | <u>Resid</u> | <u>Busns</u> | <u>Util</u> |
|--------------|--------------|--------------|-------------|
| -0.0% | 32.7% | -19.9% | -34.1% |

Court-Ordered Tax Shifts

- Tax Shifts with Shelter Allowance and Change in Personal Property Rule, Change from Current to MV Assessment

Statewide Average:

| <u>Agric</u> | <u>Resid</u> | <u>Busns</u> | <u>Util</u> |
|--------------|--------------|--------------|-------------|
| 1.8% | 13.1% | -8.3% | -13.0% |

Explanation of Shifts in Going to Court-Ordered Market Value

- Straight application of Market Value produces a \$560 m shift to residential taxpayers.
- Introduction of Shelter Allowance and IN rule reduces the shift to residential to \$220 m.
- The difference between these, \$340 m, is the shift to business from the Shelter Allowance and the IN rule.

The Shelter Allowance

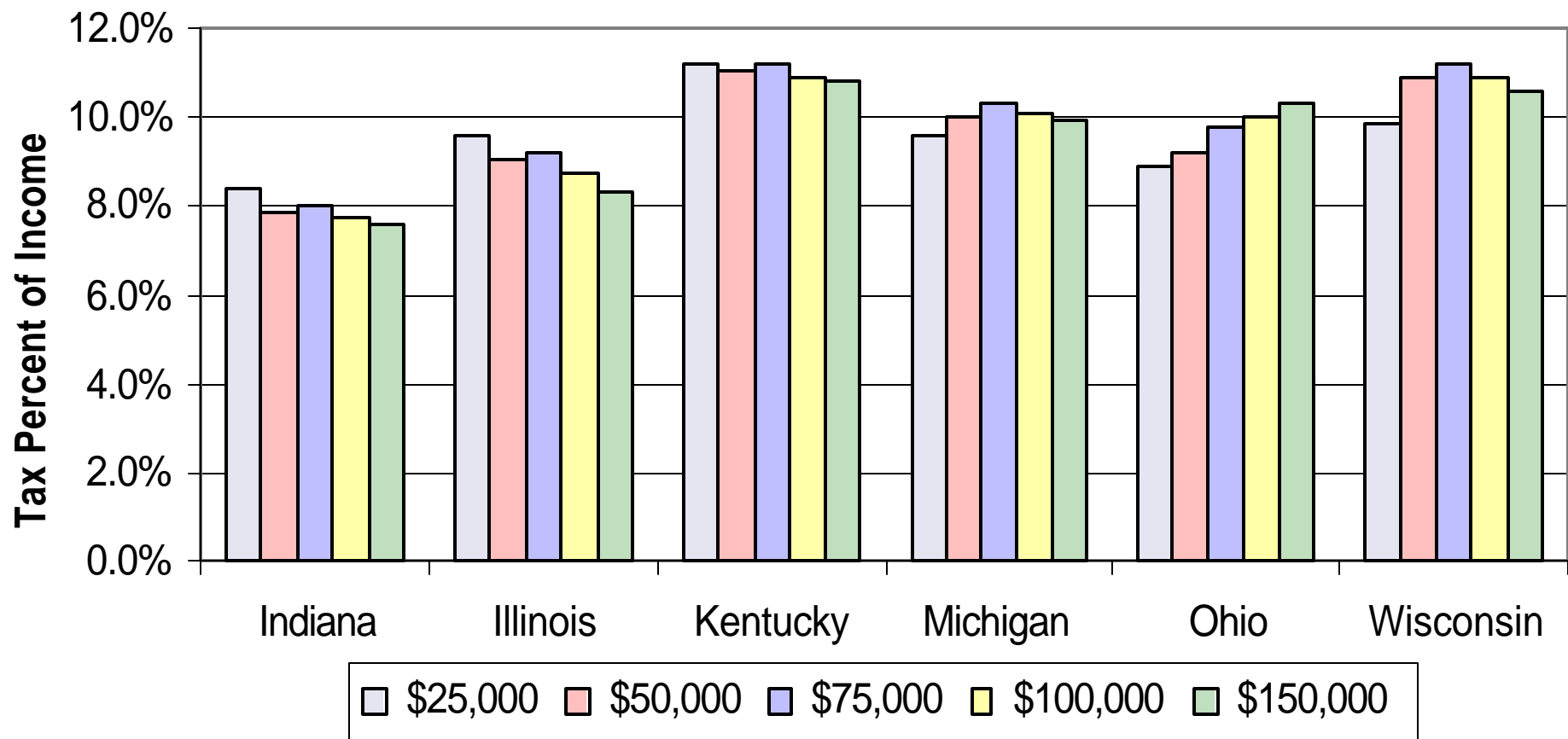
- Subsistence housing not counted as wealth
- Based on H.U.D. measurements of efficiency apartment rents
- Fixed amount per county subtracted from market value of primary residence
- Ranges from \$16,000 to \$22,700
- Reduces the increase in home assessments, significantly for lower-valued homes

Explanation of Household Incidence Analysis

- Household Model based on family of four, various income levels with homeownership or renter.
- Baseline for comparison is market value reassessment with no intervention.
- 21st Century Tax Plan assumes shelter allowance and IN rule for personal property as first steps.

Indiana State and Local Tax Burden, Current Law

Comparison by Household Income and State



Indiana's 21st Century Tax Plan

Objective 1 - Reduce Reliance on Property Taxes

| | CY'03 | CY'04 | CY'05 |
|---|---------|---------|---------|
| Taxes Reduced or Eliminated | | | |
| School Levy reduction, 50%; Gross | 896.5 | 936.8 | 978.9 |
| Eliminate Welfare Related Levies; Gross | 333.8 | 352.2 | 371.5 |
| Eliminate Trial Court Levies; Gross | 146.8 | 154.1 | 161.8 |
| Additional Police and Fire Pension Relief | 30.0 | 30.0 | 30.0 |
| Increase Homestead Credit to 15% | 57.4 | 188.6 | 267.7 |
| Eliminate Inventory Tax | 461.6 | 482.4 | 504.1 |
| Investment Tax Credit [credit on Pers Prop] | 81.4 | 87.6 | 94.3 |
| Subtotal | 2,007.5 | 2,231.7 | 2,408.3 |
| Replacement Revenue | | | |
| Sales Tax [additional 1%] | 813.0 | 857.7 | 906.6 |
| Income Tax Increase; graduated rate | 517.7 | 546.2 | 576.2 |
| Eliminate PTRC | 915.1 | 965.5 | 1,018.6 |
| Subtotal | 2,245.8 | 2,369.4 | 2,501.4 |

Indiana's 21st Century Tax Plan

Objective 2 - State/Local Economic Development and Tax Fairness Initiatives

| | CY'03 | CY'04 | CY'05 |
|---|-------|-------|-------|
| Taxes Reduced or Eliminated | | | |
| Eliminate Corp Gross Income tax | 330.0 | 346.5 | 363.8 |
| Increase R&D Income Tax Credit to 20% | 78.0 | 81.9 | 86.0 |
| Earned Income Tax Credit expansion | 28.0 | 29.4 | 30.9 |
| Renter's Deduction [increased to \$3,000] | 22.0 | 22.0 | 22.0 |
| Subtotal | 458.0 | 479.8 | 502.7 |

| | | | |
|---|-------|-------|-------|
| Replacement Revenue | | | |
| Business Franchise Tax | 330.0 | 344.9 | 360.4 |
| Increase in Corporate Net Income tax rate of .75% | 105.0 | 110.3 | 115.8 |
| Subtotal | 435.0 | 455.2 | 476.2 |

| | | | |
|--------------------|-------|-------|-------|
| IN Tax Relief Fund | 107.7 | 164.3 | 197.6 |
|--------------------|-------|-------|-------|

| | | | |
|--|-------|-------|-------|
| Tuition Support Stabilization Trust Fund | 107.7 | 164.3 | 197.6 |
|--|-------|-------|-------|

Comparison of Tax Shifts under MV Assessment and 21st Century Tax Plan

- Tax Shifts with Shelter Allowance and Change in Personal Property Rule, Change from Current to 21st Century Tax Plan

Statewide Average:

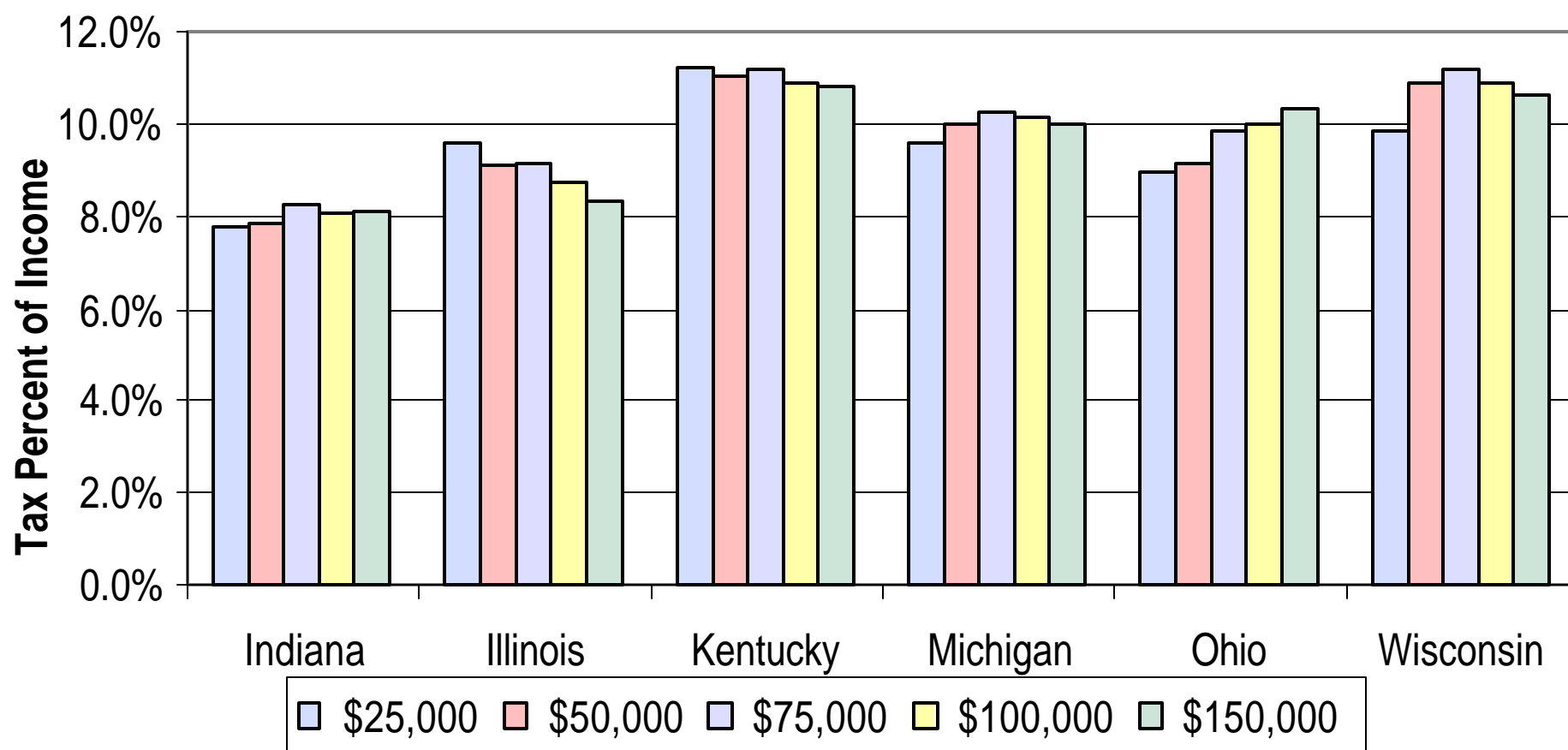
| <u>Agric</u> | <u>Resid</u> | <u>Busns</u> | <u>Util</u> |
|--------------|--------------|---------------|---------------|
| -9.1% | 0.0% | -31.1% | -28.2% |

- Tax Shifts with no Shelter Allowance or Change in Personal Property Rule, Change from Current to MV Assessment

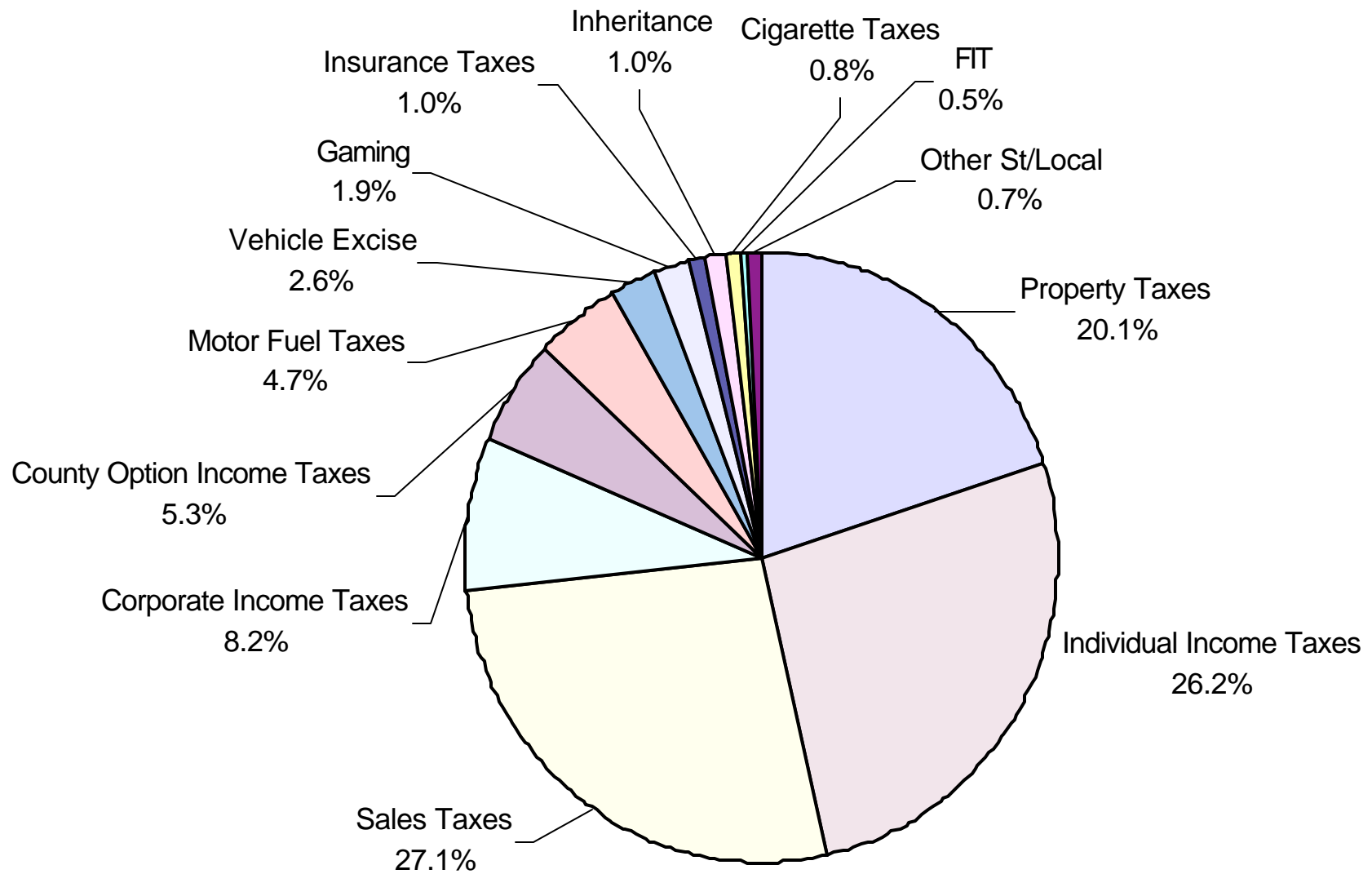
Statewide Average:

| <u>Agric</u> | <u>Resid</u> | <u>Busns</u> | <u>Util</u> |
|--------------|--------------|---------------|---------------|
| -0.0% | 32.7% | -19.9% | -34.1% |

21st Century Tax Plan, Indiana State-Local Tax Burden Comparison by Household Income and State



21st Century Tax Plan, Indiana State and Local Taxes, 2004



Comparison of Current Structure and 21st Century Tax Plan – Revenues Reduced or Eliminated

| Elements of Plan | Current Structure | 21 st Century Tax Plan |
|---|-------------------|-----------------------------------|
| Homestead Credit | 10% | Raise to 15% |
| Corporate Gross Income Tax | .3-1.2% | Eliminate ² |
| R&D Income Tax Credit | 5% | Raise to 20%; no apprt. |
| Inventory Tax | Yes | Eliminate (thru credit) |
| Personal Property Investment Tax Credit | No | Yes |
| Renter's Deduction | \$2,000 | \$3,000 |
| School Gen Fund Levy | - | Reduce by 50% |
| Family and Children Fund Levy | - | Eliminate |
| Hospital Care for Indigent | - | Eliminate |
| Trial Court Levy | - | Eliminate |
| Pension Relief Fund (police and fire) | - | Additional \$30 m |
| Earned Income Tax Credit | Income < \$12,000 | Income < \$18,000 |

² Corporate Gross Tax is eliminated and the Corporate Adjusted Gross Income Tax and the Corporate Supplemental Net Income Tax are combined into a single income tax at 8.5%, .75% above the current rate.

Comparison of Current Structure and 21st Century Tax Plan – Revenues Raised

| Elements of Plan | Current Structure | 21 st Century Tax Plan |
|---------------------------------|------------------------|--|
| Sales Tax | 5% | 6% |
| Income Tax | 3.4% (flat rate) | 3.9% income < \$90,000 4.4% income > \$90,000 |
| Taxpayer & Spouse Exemption | \$1,000 | \$1,000 |
| Add'l Dependent Child Exemption | \$1,500 | \$2,000 |
| Business Franchise Tax | No | Yes |
| Property Tax Replacement Credit | 20% of specific levies | Restructure |

21st Century Tax Plan

Background on Indiana's Tax Structure

- **Level of Taxation on Individuals**

- For most Hoosiers, Indiana's tax burden is below average compared to other states.
- Total taxes, as a percentage of income, are lowest in Indiana of the Midwest states.
- The lowest income individuals in Indiana pay a higher percentage of their income in taxes compared to other Hoosiers.

- **Level of Business Taxation**

- Indiana's reliance on business taxes is 31% more than the U.S. average.
- Indiana is the only Midwest state with a gross receipts tax.
- Only Indiana and Ohio tax business inventory, and Ohio has begun a long-term phase-out.

Indiana's 21st Century Tax Plan

- **Reducing Reliance on Property Taxes**

- **General Property Tax Relief**

- ✓ Reduce school statewide general fund levy by 50% through increased state funding.
 - ✓ State replaces the remaining welfare levies (family and children fund, HCI/UPP, children with special healthcare needs, and medical aid to wards).
 - ✓ State replaces remaining local trial court levies through state replacement funding.
 - ✓ Reduce civil unit levies by increasing the amount of pension relief funding for police and firefighters by \$30 million per year.

- **Targeted Residential Property Tax Relief**

- ✓ Increase the homestead credit to 15%.

- **Targeted Business Tax Relief**

- ✓ Eliminate the inventory tax.
 - ✓ Establish a new personal property investment tax credit to encourage new investment in job creating business equipment.

Indiana's 21st Century Tax Plan

- **Modernizing State/Local Tax Structure to Encourage Economic Development**
 - **Targeted Individual Tax Relief**
 - ✓ Increase the earned income tax credit income threshold from \$12,000 to \$18,000.
 - ✓ Increase the renter's deduction from \$2,000 to \$3,000.
 - **Targeted Business Tax Relief**
 - ✓ Eliminated the corporate gross income tax.
 - ✓ Increase the R&D tax credit from 5% to 20%.

Indiana's 21st Century Tax Plan

- **Finding Replacement Revenue**
 - **Financing Reduced Reliance on Property Taxes**
 - ✓ Increase the sales tax rate from 5.0% to 6.0%.
 - ✓ Establish a two-tier graduated income tax structure:
 - 3.9% for incomes up to \$90,000
 - 4.4% for incomes \$90,000 or over
 - Increase the dependent deduction by \$500
 - ✓ Eliminate property tax replacement credits.
 - **Financing Tax Structure Modernization**
 - ✓ Implement a broad-based franchise tax on all business entities.
 - ✓ In conjunction with elimination of the corporate gross income tax, combine adjusted gross income tax and the supplemental net income tax into one corporate income tax at a rate of 8.5%.

Rationale For Elements Included In Indiana's 21st Century Tax Plan

Objective 1 - Reduce Reliance on Property Taxes

A. Taxes Reduced or Eliminated

1. School Levy reduction, 50%:
 - Provides substantial property tax relief.
 - Retains equalization provisions of tuition support formula.
 - Retains local control by school boards in financial decision-making.
 - Increases the state's funding responsibility from 60% to 80% of the school general fund support.
2. Eliminate Welfare Related Levies:
 - Provides substantial property tax relief.
 - Places the responsibility welfare funding with the administering entity (the state).
 - Eliminates the local levy so that it cannot continue to grow in the future.
 - Eliminates perceived disparities between tax contributions and distribution of benefits.
3. Eliminate Trial Court Levies:
 - Provides substantial property tax relief.
 - Consolidates and coordinates corrections policy-making, resulting in a more efficient system.
 - Creates a more rational and effective system for administering the state's trial court system.
 - Transfers all trial court fees and charges to the state.
4. Additional Police and Fire Pension Relief:
 - Provides property tax relief.
 - Increases the amount of state funds available to help civil units finance police and fire pension payments.
 - Reduces local levies by an amount equal to the relief provided.
5. Increase Homestead Credit to 15%:
 - Provides substantial, targeted property tax relief to residential property taxpayers.
 - Prevents current homestead credit from dropping from its temporary 10% level to 4% effective 1/1/2004.
 - Permanently establishes the credit at 15%.

6. Eliminate Inventory Tax:
 - Increases competitive economic advantage for Hoosier businesses and farmers.
 - Provides a strategic advantage over Ohio, the only Midwestern state with a remaining inventory tax.
 - Encourages manufacturing and warehouse/distribution expansion and relocation in Indiana.
 - Eliminates incentive to reduce or relocate inventory to avoid taxation.
7. Investment Tax Credit [Credit on Personal Property]:
 - Provides incentive for capital investment under straight-line depreciation schedule.
 - Provides a tax credit for personal property amounting to 25% in the first year and 15% in the second year.

B. Replacement Revenue

1. Sales Tax [additional 1%]:
 - Generates substantial amounts of revenue for tax relief.
 - Maintains competitive sales tax for Indiana (current 5.0% rate is lower than all surrounding states except Ohio.)
 - Preserves categories of items taxed.
 - Moves Indiana's sales tax rate from the lowest to the third lowest among neighboring states.
2. Income Tax increase [graduated rate]:
 - Establishes progressive tax structure based on ability to pay.
 - Institutes a rate of 3.9% on the first \$90,000 of taxable income and 4.4% for all taxable income above \$90,000.
3. Eliminate PTRC:
 - Exchanges general revenue sharing for state payments of specific program costs.
 - Minimizes the potential for diluting property tax relief. (Exclusions for capital and debt service levies have reduced the effective rate of the credits from 20% to about 14%.)

Objective 2 - State/Local Economic Development and Tax Fairness Initiatives

A. Taxes Reduced or Eliminated

1. Eliminate the Corporate Gross Income Tax:
 - Improves Indiana's competitive business climate by eliminating the archaic gross receipts tax.
 - Encourages economic development, especially the attraction of new companies.
 - Removes tax penalty for businesses that have large revenues and low margins.
2. Increase R&D Income Tax Credit to 20%:
 - Eliminates the apportionment factor as it applies to the credit.
 - Increases the amount of the credit from 5% to 20%.
 - Encourages companies that must invest heavily in new product development to locate and expand in Indiana.
 - Provides the greatest incentive in the country to encourage investment in Indiana, creating high wage, high-skill jobs.
 - Benefits universities, businesses, and graduates throughout Indiana.
3. Earned Income Tax Credit expansion:
 - Provides targeted tax relief to low-income Hoosiers and encourages self-sufficiency for low income working Hoosiers.
 - Doubles the amount available for EI credits.
 - Increases the income eligibility threshold from \$12,000 to \$18,000 per year.
4. Renters' Deduction [increased to \$3,000]:
 - Provides additional tax relief to individuals who live in rental housing.
 - Increases Renter's Deduction from \$2,000 to \$3,000 per tax return.

B. Replacement Revenue

1. Business Franchise Tax:
 - Insures that the state will have a reliable source of business tax income.
 - Distributes the tax business tax burden more broadly across all Indiana companies.
2. Increase in Corporate Net Income tax rate of .75%:
 - Combines the adjusted gross and supplemental net income tax into a single tax.
 - Sets the Corporate Net Income tax rate at 8.5%, the same as current Financial Institutions Tax.

Objective 3 – Create Dedicated Trust Funds for Tax Relief Stability

A. Indiana Tax Relief Fund*

- This fund is dedicated to guaranteeing that, in the event of an economic downturn or decline in revenues, the state will be able to fulfill its obligations to ongoing tax relief.
- If the fund balance is determined to be above a reasonable reserve, the overage may only be applied to additional tax relief.

B. Tuition Support Stabilization Fund*

- This fund provides targeted safeguards and opportunities for the state's increased obligation to provide school general fund support.
- Due to the importance of stable education funding, a specific tuition support fund is warranted.

* Net revenues from Objective I and Objective II. Are combined and divided evenly between the Indiana Tax Relief Fund and the Tuition Support Stabilization Fund. This mechanism protects the revenue neutrality of the tax remodeling initiative.